**DEPARTMENT OF STATE REVENUE**
**LETTER OF FINDINGS: 02-0070**
**INDIANA INDIVIDUAL INCOME TAX**
**For the Tax Year 2000**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

## ISSUES

### I. Imposition of the State's Individual Income Tax By Reference to Taxpayer's Federal Adjusted Gross Income.

**Authority**: Ind. Const. art. IV, § 1; IC 6-3-1-3.5; Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415 (Ind. 1957); IAC 3.1-1-1.

Taxpayer argues that the state may not impose its own adjusted gross income tax by reference to the taxpayer's federal adjusted gross income.

### II. Definition of "Taxpayer" for the Purpose of Assessing the State's Individual Income Tax.

**Authority**: Ind. Const. art. X, § 8; IC 6-2.1-1-16; IC 6-2.1-2-2; IC 6-3-1-1 et seq.; IC 6-3-1-9; IC 6-3-1-12.

Taxpayer maintains that, for purposes of assessing the state's individual adjusted gross income tax, he is not a statutorily defined "taxpayer" subject to imposition of the tax.

### III. Definition of "Income" as Applied to Individual Indiana Residents for the Purpose of Imposing the State's Individual Income Tax.

**Authority**: Ind. Const. art. X, § 8; IC 6-3-1-3.5 et seq.; New York v. Graves, 300 U.S. 308 (1937); Merchant's Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1921); Doyle v. Mitchell, 247 U.S. 179 (1918); United States v. Connor, 898 F2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F2d 1328 (7th Cir. 1984); United States v. Ballard, 535 F.2d 400 (8th Cir. 1976); United States v. Romero, 640 F2d 1014 (9th

Cir. 1981); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer argues that, even by reference to the federal Internal Revenue Code, he did not receive "income" for purposes of assessing the state's individual income tax. According to taxpayer, only corporate entities are subject to that tax.

## STATEMENT OF FACTS

Taxpayer filed an individual income tax return for the year ending December 31, 2000. On that return, taxpayer reported federal adjusted gross income of "0." Taxpayer subsequently received a "Notice of Proposed Assessment" indicating that taxpayer owed taxes, penalty, and interest. Taxpayer replied stating that the proposed assessment was erroneous and that because the taxpayer reported no federal adjusted gross income, he had no liability for Indiana adjusted gross income tax. Accordingly, the taxpayer demanded that the amount of taxes previously withheld from the taxpayer in the amount of $3,300 be returned immediately. The Department declined taxpayer's invitation to refund the withheld amount, an administrative hearing was held to determine the basis for taxpayer's protest, and this Letter of Findings followed.

## DISCUSSION

### I. Imposition of the State's Individual Income Tax By Reference to Taxpayer's Federal Adjusted Gross Income.

After taxpayer reported "0" adjusted gross income on his federal return, the taxpayer reported "0" adjusted gross income on his state return. According to taxpayer, he was compelled to do so based upon the explicit instructions included on the Indiana return. Ancillary to that proposition, is taxpayer's argument that Indiana may not statutorily incorporate by internal reference the federal definition of "adjusted gross income."

It is undisputed that the Indiana tax return for the tax year 2000 employs federal adjusted gross income as the starting point for determining the taxpayer's state individual income tax liability. Line one of the IT-40 form requires the taxpayer to "Enter your federal adjusted gross income from your federal return (see page 9)."

IC 6-3-1-3.5 states as follows: "When used in IC 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code) . . . ." Thereafter, the statute proceeds to delineate specific addbacks and deductions, peculiar to Indiana, which modify the federal adjusted gross income amount. The Department's regulation concisely restates the same formulary principal. 45 IAC 3.1-1-1 defines individual adjusted gross income as follows:

> Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is "Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:
>
> > (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
> > (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
> > (3) Make all modifications required by IC 6-3-1-3.5(a).

Both the statute, IC 6-3-1-3.5, and the accompanying regulation, 45 IAC 3.1-1-1, require that an Indiana taxpayer employ the federal adjusted gross income calculation, as determined under I.R.C. § 62, as the starting point for determining the taxpayer's Indiana adjusted gross income.

Taxpayer's contention – that he was compelled by force of law to declare "0" as Indiana adjusted gross income because he declared "0" on his federal return – is patently without merit. The statute is plain and unambiguous. Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 62, not as reported by the taxpayer. *See* Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). The directions contained within the Indiana income tax form provide the individual taxpayer with abbreviated directions for completing the form and not the means for determining the taxpayer's adjusted gross income. The Indiana tax form instructs the taxpayer to put what number in what box. Those directions notwithstanding, taxpayer is nonetheless required to actually perform the calculations necessary to determine his liability for Indiana adjusted gross income tax.

In addition, taxpayer argues that the Indiana Constitution does not permit references to another taxing jurisdiction's own laws and when faced with such an improper reference – such as that found within IC 6-3-1-3.5 – the taxpayer's compliance is not required.

The Indiana Constitution specifically and exclusively vests legislative authority in the Indiana General Assembly. "The Legislative authority of the State shall be vested in a General Assembly, which shall consist of a Senate and a House of Representatives. The style of every law shall be: 'Be it enacted by the General Assembly of the State of Indiana': and no law shall be enacted, except by bill." Ind. Const. art. IV, § 1. Taxpayer is correct in his assertion that that Indiana General Assembly may not delegate either its authority or its responsibility for performing its exclusively legislative functions. "The power to legislate or to exercise a legislative function cannot be delegated to a non-governmental agency or person. Nor can the Legislature delegate its law-making power to a governmental officer, board, bureau or commission." Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415, 419 (Ind. 1957) (Internal citations omitted).

On its face, taxpayer's contention appears to have merit. The Indiana General Assembly may not delegate its responsibility for defining the state's adjusted gross income tax scheme to the federal government. However, the cross-reference to I.R.C. § 62 contained within IC 6-3-1-3.5 does not delegate any such authority. The Indiana Code provision reflects merely the legislature's considered and independent decision to use the federal calculation as the starting point for determining Indiana's adjusted gross income tax. "It is well settled that a legislative body may

enact a law, the operation of which depends upon the existence of a stipulated condition." Campbell v. Heiss, 53 N.E.2d 634, 636 (Ind. 1944). That the Indiana General Assembly has assiduously retained authority to stake out the parameters of the state's adjusted gross income tax scheme is evidenced by the Assembly's decisions to periodically reenact IC 6-3-1-3.5 the latest of which occurred in 2001. Whether the General Assembly should have avoided a reference to I.R.C. § 62 by independently drafting original statutory provisions mirroring the Internal Revenue Code and then require every Indiana taxpayer to recalculate his taxable income, is an issue beyond the scope of this Letter of Findings and irrelevant to determining taxpayer's tax liability. Suffice it to say that the General Assembly acted entirely within its authority in employing the federal adjusted gross income as the jumping off point for calculating the individual taxpayer's Indiana adjusted gross income.

## FINDING

Taxpayer's protest is denied.

## II. Definition of "Taxpayer" for the Purpose of Assessing the State's Individual Income Tax.

Taxpayer argues that he is not a statutorily defined "taxpayer" required to pay Indiana adjusted gross income tax. In support of his assertion, taxpayer cites to IC 6-2.1-1-16 stating that he does not fall within one of the enumerated categories defining "taxpayer." IC 6-2.1-1-16 states in its entirety:

> "Taxpayer" means any: (1) assignee; (2) receiver; (3) commissioner; (4) fiduciary; (5) trustee; (6) institution; (7) national bank; (8) bank; (9) consignee; (10) firm; (11) partnership; (12) joint venture; (13) pool; (14) syndicate; (15) bureau; (16) association; (17) cooperative association; (18) society; (19) club; (20) fraternity; (21) sorority; (22) lodge; (23) corporation; (24) municipal corporation; (25) political subdivision of the state of Indiana or the state of Indiana, to the extent engaged in private or proprietary activities or business; (26) trust; (27) limited liability company (other than a limited liability company that has a single member and is disregarded as an entity for federal income tax purposes); or (28) other group or combination acting as a unit.

Taxpayer is correct in his basic assertion that he does not fall within one of the enumerated categories of "taxpayer" as set out in IC 6-2.1-1-16. Taxpayer is also correct in claiming that he is in not subject to the state's gross income tax scheme. However, that determination is ultimately pointless because no individual is *ever* subject to gross income tax. The state's gross income tax is imposed exclusively on corporate business entities which are either residents or domiciliarys of Indiana or on non-resident business entities which nonetheless derive income from doing business within the state. IC 6-2.1-2-2.

Taxpayer's concern is – or should be – with the provisions of the individual adjusted gross income tax provisions as set out in IC 6-3-1-1 et seq. In establishing the adjusted gross income

tax, the Indiana General Assembly exercised its prerogative, under Ind. Const. art. X, § 8, to impose the tax on both individuals and corporations. In doing so it defined an individual, subject to the adjusted gross income tax as, "a natural born person, whether married or unmarried, adult or minor." IC 6-3-1-9.

Given that taxpayer is a "natural born person," was a resident of Indiana for the year 2000 (IC 6-3-1-12), and presumptively received taxable income, the statutes imposing the state's individual adjusted gross income tax apply with full force to the taxpayer.

## FINDING

Taxpayer's protest is denied.

## III. Definition of "Income" as Applied to Individual Indiana Residents for the Purpose of Imposing the State's Individual Income Tax.

Taxpayer argues that he did not receive "income" during the year 2000. Liberally construed, taxpayer's argument is that – for purposes of determining income tax liability – "income" can only be derivative of corporate activity. Therefore, as an individual Indiana resident who by definition did not receive "corporate" income, taxpayer is not subject to the adjusted gross income tax.

In support of that proposition, taxpayer cites to a number of Supreme Court cases including Doyle v. Mitchell, 247 U.S. 179 (1918); Merchant's Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1921); and a federal circuit court case, United States v. Ballard, 535 F.2d 400 (8th Cir. 1976).

In Doyle, the Court stated that "Whatever difficulty there may be about a precise and scientific definition of 'income' it imports . . . the idea of gain or increase arising from corporate activities." Doyle at 185. In Smietanka, the Court stated that, "There can be no doubt that the word [income] must be given the same meaning and content in the Income Tax Acts of 1916 and 1917 that it had in the Act of 1913." Smietanka at 519. Similarly, the same Court stated, "there would seem to be no room to doubt that the word must be given the same meaning in all of the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of this court." Id. Taxpayer reads these and the cited companion cases as supporting the proposition that the federal income tax – and by extension Indiana's adjusted gross income tax – can only be levied against corporate gain. According to taxpayer, the cases inevitably lead to the conclusion that "income" – as referred to within both the federal and companion state statutes – is exclusively limited to that definition as established under the Civil War Income Tax Act of 1867; the Corporation Excise Tax Act of 1909; and the Income Tax Acts of 1913, 1916, and 1917.

However, the cited cases do not permit such a conclusion. In the cases cited by taxpayer, the Court was asked to determine the definition of corporate income. In Doyle, the Supreme Court

was asked to resolve the issue of whether the increase in value of the corporate taxpayer's standing timber constituted "income." In determining that the increase in value did not constitute corporate "income," the Court stated that the definition of corporate income had remained unchanged during the intervening recodifications of the federal corporate income tax and the ratification of the Sixteenth Amendment to the United States Constitution. In Smietanka – resolving the issue of whether a provision in a will, stipulating that accretions in the value of testamentary property should be considered additions to principal and not income – the court similarly noted that the definition of "income" had remained unchanged. The Court went on to state that. "In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. . . ." Smietanka at 519.

The cited cases support the proposition that corporate gain is subject to the existing federal corporate income tax scheme. The cited cases do nothing to support the assertion that *only* corporate gain is subject to the tax. Simply stated, if the courts are asked to define "corporate income," the courts will arrive at a conclusion which defines "corporate income."

In United States v. Ballard, 535 F.2d 400 (8th Cir. 1976), the court stated, in determining appellant taxpayer's individual income tax liability, that, "The general term "income" is not defined in the Internal Revenue Code." Id. at 404. Rather, the court noted that the Internal Revenue Code operates under and employs the term "gross income." Id. However, nothing in Ballard can be read to support the proposition that the federal adjusted gross income tax is only applicable to corporate gain or that individual taxpayers' wages are not subject to imposition of the federal adjusted gross income tax. To the contrary, the court found that appellant taxpayer was liable for additional income taxes on wages received from his business. Id. at 405.

The question of what constitutes individual taxable "income" has been answered by the courts. Although not binding upon Indiana's decision to tax the wages of its own citizens, the United States Supreme Court has definitively ruled on the question of whether a citizen's individual income may be subjected to an adjusted gross income tax. In New York v. Graves, 300 U.S. 308, 312-13 (1937), Justice Stone stated as follows:

> That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protect of its laws are inseparable from the responsibility for sharing the costs of government . . . . A tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits. The tax, which is apportioned to the ability of the taxpayer to pay it, is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state. To them and to the equitable distribution of the tax burden, the economic advantage realized by the receipt of income and represented by the power to control it, bears a direct relationship. Neither the privilege nor the burden is affected by the character of the source from which the income is derived.

Since that 1937 decision, the federal courts have consistently, repeatedly, and without exception determined that individual wages – no matter in what form the taxpayers have attempted to characterize, define, or label those wages – are income subject to taxation. United States v. Connor, 898 F2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income"); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); Coleman v. Commissioner of Internal Revenue, 791 F2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); United States v. Koliboski, 732 F2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable.") (Emphasis in original); United States v. Romero, 640 F2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable. . . . [Taxpayers] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical question, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United Sates Supreme Court and federal circuit courts, and this Court's opinion . . . all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). *See also* Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayers' distinctions aside, taxpayer's income – by whatever linguistic device the taxpayer may wish to characterize that income – is subject to Indiana's adjusted gross income tax as defined by the General Assembly under IC 6-3-1-3.5 et seq. and as authorized by the Indiana Constitution. Ind. Const. art X, § 8.

## FINDING

Taxpayer's protest is denied.

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